Via email to regcomments@ncua.gov

April 6, 2009

The Honorable Michael E. Fryzel
Chairman, National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

The Honorable Rodney E. Hood
Vice Chairman, National Credit Union Administration

The Honorable Gigi Hyland
Board Member, National Credit Union Administration

Re: Advanced Notice of Proposed Rulemaking to 12 CFR Part 704

Dear Chairman Fryzel, Vice Chairman Hood, and Board Member Hyland:

On behalf of Constitution Corporate Federal Credit Union (Constitution), we are pleased to have the opportunity to provide comments to the National Credit Union Administration (NCUA) regarding the Advanced Notice of Proposed Rulemaking for Part 704 (ANPR). In light of the credit market meltdown that has created losses in excess of $1.2 trillion among financial institutions worldwide, we support NCUA's Corporate Stabilization Program and the actions taken by the agency to address the stresses among corporate credit unions.

In developing our comments on the issues identified by NCUA, Constitution held a number of meetings with its member-owners to gain their insight into the ANPR and to gain the insight of how credit unions viewed the concepts and possible changes to regulations that govern corporate credit unions. As a member owned cooperative, Constitution has evolved to meet the needs of its members and believes that changes to the Corporate's role, capitalization, product/service offerings and governance is at the direction of its member-owners. A summary of the sessions with member-owners is attached to this response.

Constitution has had the great honor of serving its member-owner credit unions for the last 30 years. These members, principally in Connecticut, range from the smallest part time operations to hundred million dollar multi-branch credit unions with a myriad of services. The average assets of credit unions in Connecticut are under the national average requiring the efficient sharing and leveraging of resources to benefit the industry as a whole. Virtually all natural person credit unions in the state are full capitalized members of Constitution. Over 80% of its capitalized members have less than $50 million in total assets as of 12/31/08.

47 Barnes Industrial Park Road South Wallingford, CT 06492-2431
www.constitutioncorp.org P:203-697-6000 800.352.3823 F:203.294.6122

Constitution has worked hard to remain a vibrant, integrated part of the credit union industry. It views its role based on the classic cooperative principles of the industry - voluntary membership, democratic member control and cooperation among cooperatives.

Constitution has developed and grown over the past three decades with its member-owners helping them compete with the strains of shrinking operating margins and increased operating costs. Every individual at Constitution knows and appreciates they work for their member-owner credit unions and that they are part of the credit union community. We are gratified by the strong support we receive from our member-owners. Hopefully members' responses to the Advanced Notice of Proposed Rulemaking such as, "Corporates offer an invaluable resource to Credit Unions," and "we like and need our corporate credit union," will not go unheeded in the agency's deliberations.

Context & Overview

The world continues to struggle with an economic crisis not seen since the Great Depression. Restructuring called for in the ANPR should be assessed with extreme due care and diligence so as not to jeopardize the very existence and success of those credit unions. Establishing regulation developed in the midst of a confusing and quickly changing crisis environment is extremely challenging.

The prospects for and impact of federal legislation proposed in the last few days of a Corporate Credit Union Stabilization Fund (CCUSF) which would help spread out insurance costs associated with NCUA's assistance to corporate credit unions is still being assessed. Similarly, changes in accounting regulation and guidance, one made literally in last several days on an expedited manner in light of its importance, are still being addressed and interpreted. Patience and judgment is needed in proposing rule making that in these uncertain and changing times could have extreme and dire unintended consequences.

The historic conservatorships of U.S. Central and WesCorp announced March 20 as a necessary component of the continuing NCUA Corporate Stabilization Program involved seizure of institutions with approximately $60 billion in assets. We acknowledge and respect NCUA's conclusion that, "actions taken represent the least cost alternative and least disruption to the overall credit union and U.S. financial system."

The impairment of U.S. Central capital will however likely require a charge to reserves that, when coupled with any additional OTTI charge, may exhaust reserves and result in consideration of an accounting impairment, at some point, to member capital share deposits (MCSD) at Constitution. As a result of the U.S. Central conservatorship, it appears at this time the adequacy of reserves and capital at virtually every corporate credit union is of concern.

The Role of Corporates in the Credit Union System

We agree with our member-owners that corporates have historically, and should be allowed to, continue to operate effectively as an integral part of the credit union system. This role necessarily includes providing payment, liquidity and settlement services on a cost efficient basis. These services are not seen as readily available from other providers, especially relative to the needs of a large number of smaller credit unions. Corporates serve as a trusted and reliable business partner to its member-owners.

Payment Systems should not be required to be isolated from other services. We believe such isolation would create greater risks and higher costs for credit unions. Similarly, instituting charter limitations for this purpose is not warranted. We also believe there is insufficient earnings potential in offering payment systems based on a limited business model that restricts corporates to payment systems based on the back offices and cost structure involved.

Capital allocation should be considered in regulation. Sufficient timeframes should be included to permit corporate credit unions to adjust its business operations as needed.

Liquidity Services – Constitution and all corporate credit unions have traditionally offered settlement and back-up day-to-day liquidity services and has done so extremely well. Little if any losses have been incurred due to offering these services except where a corporate has expanded its lending activities beyond the original back-up role. The Central Liquidity Fund should be used in cases where credit unions require extraordinary or unusual liquidity and should serve as a direct source of liquidity for the credit union system i.e. both for corporates and natural person credit unions.

While we agree NCUA should consider risk focused policy formulation, overly restricting or limiting a Corporate's ability to offer standard liquidity products and services could severely impair operating business models. Current regulatory tools appear generally adequate to mitigate corporate liquidity risks without adding requirements such as aggregate cash flow duration limitations to Part 704. Any specific changes being proposed should be disclosed in much more detail before being considered in a rule modification.

Field of Membership (FOM) - Constitution does not believe NCUA needs a return to defined FOMs. However, it is recognized that the agency's reorganization may result in regionalization of corporates and Constitution is poised to serve the New England region. Members have made it clear to us that choice is paramount and they should not be restricted to doing business with the regulatory-mandated corporate.

Expanded investment authorities should remain permissible along with reasonable and necessary requirements that corporates assemble and maintain the intellectual capital and systems to understand and support the complexity of additional risk taking and risk monitoring. Regulatory oversight must be tailored to ensure the skills of the examination team are commensurate with the risk profile of the corporates it oversees.

It is recognized that the corporates that have leveraged expanded authorities to date are all participants in the world wide crisis that greatly underestimated the fundamental credit risk embedded in residential mortgage backed securities. Reconsideration of the regulations governing the permissible risk taking by these entities is therefore appropriate. However, it is critical to recognize the need for expanded authorities still exists.

Structure – two tiered system: Recent events has defacto eliminated U.S. Central as a member-owned entity. The previous two tiered system (wholesale [i.e., U.S. Central] and retail corporates [e.g., Constitution] should be reduced to the "retail" level to minimize the operational redundancies and overhead. A possible role for U.S. Central in the future is possibly to provide limited aggregation services for certain payment functions. The idea of a single corporate to provide efficiencies is concerning due to the systemic implications when (not if) problems arise. Corporates should continually communicate and join efforts to ensure research and development funding results in value based products and services for all credit unions.

Corporate Capital

Given the current risk environment, recognizing the loss of all capital invested in U.S. Central and Wescorp, seeking additional capital from credit unions either in the form of Tier I capital or Membership Capital Shares will be difficult if not impossible. The timing of regulation reform as to terms and conditions of capital should allow sufficient time for potential /continuing owners to consider the revised structure of corporate and related (CUSO) organizations offering services.

Consideration should be given to aligning capital structures that are comparable to other institutions such as the FHLB system.

The effectiveness and possible adoption of a risk-based capital methodology should be evaluated immediately. A methodology similar to that set forth by Basel Committee on Banking Supervision – Basel, which creates a standard regulators can use when creating regulations about how much capital needs to be available to manage against the types of financial and operations risks is inherent in the respective institution.

Permissible investments

As an aggregator of excess liquidity and as an investment alternative considered by most natural person credit unions, corporates should have investment powers greater than those of credit unions in order to provide a competitive rate of return. However, prior to investing in any instruments, corporates must build the infrastructure to support permissible investments, including the intellectual capital and analytic systems to support the complexity of the investments permitted within the corporate's board approved policies. If all credit unions were required to maintain the infrastructure to monitor and manage more complex investment, the costs would be prohibitive as a system.

While we are not in favor of specifically excluding certain investments, we do believe that a number of investments are not suitable for the short duration of liabilities that corporates manage on a daily basis. Through the use of expanded authorities, corporate must be able to demonstrate the ability to evaluate thoroughly the investments permitted within its policies and ensure that volunteers and management understand clearly the risks associated with all approved investment. Corporates seeking greater investment authority should also be required to maintain a level of capitalization to support the associated risks.

Credit risk management

The use of ratings assigned by Nationally Recognized Statistical Rating Organizations (NRSROs) should continue to be one of the variables that are utilized by investors when considering the permissibility of an investment. However, it should only be one consideration as to the credit worthiness/quality of an investment. The reliance of ratings may have been used by certain corporates and other investors during the pre-purchase due diligence and ongoing monitoring. We believe that the use of a rating as applied to a bond should only be used as a filter. Many investors such as Constitution looked beyond the ratings to the underlying collateral and the credit enhancements supporting the respective investment structures. While stress scenarios were a common practice, modeling for the events that contributed to the credit market meltdown would have been extremely difficult given the degree of inappropriate activities by originators.

While the NRSROs also had difficulty in forecasting the credit deterioration within the non-agency residential mortgage-backed securities, the degree of rating adjustments and the delay in applying downgrades as a result of collateral deterioration must be addressed. The NCUA and other regulators should request that Congress evaluate the NRSROs for any inappropriate actions in the assignment of ratings and the ongoing timeliness of any ratings actions.

Within NCUA's Rules and Regulations Part 704, a corporate must use at least one rating as assigned by one of the three NRSROs. Given the significant differences in how investment sectors may be analyzed, we believe that at least ratings from two of the NRSROs should be used as a filter for pre-purchases and for subsequent monitoring. We also believe that corporates should be required to perform stress modeling for all security types. The following summarizes our thoughts related to NCUA's credit risk management questions:

- Continue utilization of ratings provided by NRSROs (however NUCA should work with other agencies in requesting additional oversight of the NRSROs be considered in light of the perceived conflict that NRSROs have with issuers and the delay in ratings actions over the past 24 months).
- At a minimum two ratings should be utilized by corporates for pre- and post-purchase monitoring.
- Corporates should perform extensive stress modeling of investments prior to purchasing and for post-purchase monitoring.
- Require all corporates to maintain board approved policies on restricting concentrations by sector, issuer and geographic and a minimum. Ensure that compliance monitoring and reporting are automated to minimize reporting errors.
- Implement a risk-based capital allocation reporting requirement based on Basel II methodology.
- Ensure the corporate's risk based audit plan includes periodic external assessment of the credit monitoring activities. This report would be available to management, volunteers and regulators.

Asset liability management

In light of the credit market meltdown, the need for robust asset-liability management modeling is essential. While the current practice of net economic value (NEV) is extensive, many dismissed the results from the models as extreme or erroneous given the inability to secure reasonable market values on the assets. In addition to NEV stress modeling, retail corporate credit unions operate on extremely narrow interest margins. Constitution has always included a net interest income and net income component of its monthly asset-liability management modeling. We believe that all corporates should include income modeling and stressing as part of the monthly asset-liability modeling. In addition, Constitution currently runs periodic stress scenarios for credit spread changes to capture the impact spread widening and narrowing has on the value of assets and liabilities. We support NCUA's consideration of mandating the modeling and testing of credit spread changes. The following summarizes our thoughts related to NCUA's asset-liability management questions:

- Corporates should continue to employ net economic value testing and stress testing.
- Reinstate requirements for net interest income and stress testing net interest income for all corporates regardless of size or balance sheet complexity.
- Require periodic modeling and stress testing of credit spread changes (spread widening and tightening).
- Focus on the identification and allocation of all risks (interest rate risk [net economic value and net interest income], credit, liquidity and operations) and determine capital adequacy and the risk to member capital.
- Evaluate other risk management methodologies to identify potential threats to equity.

Corporate governance

As financial cooperatives, corporate credit unions are member owned democratically representative institutions. Changing this type of structure and providing compensation for volunteers has significant implications for all financial cooperatives. Currently, board members through direct action or through the Board appointed Committees have the ability to seek external resources to aid in the review/assessment of the operations and activities of the corporate. We believe that directors and management gain the external insight of this expertise through the utilization of these types of assessments.

The unique operations of a corporate credit union requires volunteers to remain well versed in the changes in the marketplace, as well as the changes and impact of such changes to the corporate. Continued focus on effective training should continue to be a requirement that all corporate boards and committees must commit to completing. Given the commitment that volunteers make to understand and represent all aspects of the corporate, we are against establishing specific term limits via regulations. There is tremendous value of a seasoned volunteer that has gained the insight as to how a corporate credit union operates and the types of risks inherent within its balance sheet and operations. Instead, we believe that term limits are at the direction of the members and that any consideration of limiting the term of a volunteer should be addressed through policy.

As to the issue of executive compensation transparency, discussions with our members provide no conclusive support for or against the disclosure. Regardless of disclosure requirement, the corporate's board is responsible for approving the Chief Executive Officer's compensation package. In many cases, board members are exposed to the compensation programs of the corporate, including any form of base and or variable pay programs. We support actions by boards to secure external assessments as to the competitiveness of the compensation programs of the corporate to similar size institutions.

The following summarizes our thoughts related to NCUA's ANPR narrative on corporate governance:

- Corporates are member owned democratically controlled financial cooperatives. Outside director representation should not be permitted.
- Corporates should remain as member owned financial cooperatives governed by volunteers and therefore compensation for serving on the board or a committee is not an option.
- The Board and committees have the ability to secure assessments related to the operations and risk position of the corporate through external resources.
- Allow the membership to determine the appropriateness of term limits.
- Require all volunteers, management and staff to continually enhance their proficiencies related to the operations and risks through ongoing training including by regulators if possible.
- Corporate boards should determine the appropriateness of compensation programs for executive officers.

We appreciate the opportunity to share our comments to you on this very sensitive and emotional issue. We respectfully request that prior to implementing changes to the corporate system and the rules and regulations governing the activities of a corporate that continued dialogue is available to the corporates and our member-owners.

Respectfully,

Robert T Nealon William F. White

Robert T. Nealon
President/Chief Executive Officer

William F. White
Executive Vice President

cc: Ms. Mary Rupp, Secretary of the Board, NCUA